

Message Text

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INFO USMISSION OECD PARIS

AMEMBASSY BONN

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C O N F I D E N T I A L SECTION 01 OF 02 LONDON 10004

FOR SECRETARY KISSINGER FROM AMBASSADOR RICHARDSON

E.O. 11652: XGDS-1

TAGS: ENRG

SUBJECT: THE OIL - MONEY PROBLEM

REF: LONDON 8338

SUMMARY: HAROLD LEVER REVIEWED WITH ME HIS IDEAS ON DEALING WITH THE OIL-MONEY PROBLEM. THEY ARE SUMMARIZED BELOW. THE CENTRAL THEME IS THAT OPEC WILL NOT COLLAPSE AND THAT A DEAL WITH THE OPEC COUNTRIES INVOLVING INDEXATION OF THE OIL PRICE FOR A FEW YEARS AHEAD IS IN OUR INTEREST. LEVER THINKS PRIME MINISTER WILSON WILL SUPPORT HIS VIEWS AND EXPECTS HE WILL PUT THEM FORWARD TO CHANCELLOR SCHMIDT AND PRESIDENT GISCARD AT THE EC SUMMIT (JULY 16-17). HE THINKS SCHMIDT IS RECEPTIVE. WHILE I KNOW LEVER HAS BEEN PUTTING FORTH THESE SAME VIEWS FOR A YEAR OR MORE AND I HAVE NOT HAD THE BENEFIT OF HEARING A FULL PRESENTATION BY THOSE WHO DISAGREE, LEVER SEEMS TO ME TO HAVE MADE A STRONG PRIMA FACIE CASE, PARTICULARLY IN VIEW OF DEVELOPMENTS IN THE PAST YEAR. THE PLAN HE OUTLINED IS ONE WHICH I
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THINK WE SHOULD SERIOUSLY CONSIDER ADOPTING.
END SUMMARY

1. HAROLD LEVER, WHO IS PRIME MINISTER WILSON'S PRINCIPAL ECONOMIC ADVISER, HAS GIVEN ME A FULL RUN DOWN OF HIS IDEAS FOR DEALING WITH THE OIL-MONEY PROBLEM. IT'S ESSENTIAL POINTS ARE SUMMARIZED IN THE FOLLOWING PARAGRAPHS 2 - 5.

2. BECAUSE OIL IS SO NECESSARY TO SO MANY CONSUMERS, OPEC MONOPOLY POWER IS MOST UNLIKELY TO BE BROKEN BY ECONOMIC FORCES FOR MANY YEARS. CONSERVATION AND THE DEVELOPMENT OF ALTERNATIVE ENERGY SOURCES MAY ACTUALLY INTENSIFY THE USE OF THAT POWER. IN THE ABSENCE OF A DEAL WITH THE CONSUMERS, OPEC WILL GO ON RAISING THE PRICE OF OIL. ONLY POLITICAL CONSIDERATIONS PREVENT OPEC FROM MOVING MORE QUICKLY TOWARDS THE TRUE MONOPOLY PRICE WHICH MUST BE MUCH HIGHER THAN THE CURRENT PRICE.

3. TO IMPROVE UPON AN INCREASINGLY ADVERSE SITUATION IN THE NEXT SEVERAL YEARS, THE CONSUMERS HAVE ONLY THE CHOICE OF EVENTUAL WAR OR A DEAL WITH THE PRODUCERS. A DEAL FETTERS THE PRODUCERS' MONOPOLY POWER, SO THE PRICE WILL BE HIGH. PART OF THE PRICE WOULD BE AN EFFECTIVE RENUNCIATION BY CONSUMERS OF THE OPTION OF WAR: THIS WOULD BE A SMALL CONCESSION IF WE ARE NOT PREPARED TO USE THE OPTION, BUT IMPORTANT TO THE PRODUCERS. A DEAL WOULD ALSO HAVE TO CONSOLIDATE AND VALIDATE THEIR PRICE GAINS, AND IT WOULD BE MORE ATTRACTIVE IF IT PROVIDES THEM WITH GREATER SECURITY FOR THEIR FINANCIAL ASSETS. THEY ARE AWARE THAT THEIR HUGE RESERVES WON'T BE WORTH ANYTHING IF THEY ARE FROZEN, DEPRECIATED OR DEFAULTED. BUT ONCE THE PRODUCERS HAVE MADE A DEAL, IT WILL BE IN THEIR INTEREST TO STICK TO IT. THEY WILL STICK TO IT PARTLY FOR THE REASONS THEY WOULD ENTER THE DEAL IN THE FIRST PLACE. BUT THEY WOULD HAVE OTHER REASONS: THE GOOD OPINION OF THE US AND OTHER CONSUMERS PROTECTS THEM FROM SUPERIOR COERCIVE POWER AND THEY WOULD NOT RISK THIS BY BREAKING AN AGREEMENT WITH GOVERNMENTS.

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4. A VIABLE DEAL MUST COVER PRICE FOR A NUMBER OF YEARS AND SECURITY OF SUPPLY. IN THIS CONTEXT PRICE MEANS AN INDEXED PRICE. HOWEVER PRICE INDEXATION IS LIKELY TO BENEFIT THE CONSUMERS BECAUSE IT REPRESENTS A RESTRICTION OF THE PRODUCERS' MONOPOLY POWER.

5. A VIABLE DEAL MUST ALSO COVER THE DISPOSITION OF THE PRODUCERS' FINANCIAL SURPLUS. THIS ENTAILS A DEAL WHEREBY THE PRODUCERS' FUTURE FINANCIAL ASSETS ARE INDEXED AND LOCKED INTO SOME INTERNATIONAL INSTITUTION.

THUS THE PRODUCERS BENEFIT BY A GUARANTEE OF THEIR
ASSETS, THE CONSUMERS BY NOT HAVING THEIR ECONOMIES
PENETRATED BY OPEC INVESTMENT, AND BOTH PARTIES BY THE

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 10004

REMOVAL OF VAST FUNDS WHICH UNDERMINE WORLD FINANCIAL
STABILITY AND THREATEN INTERNATIONAL ECONOMIC COOPERA-
TION. INDEXING FINANCIAL ASSETS NEED NOT MAKE THE
CONSUMERS WORSE OFF THAN IF THE PRODUCERS WERE FREE TO
DEPLOY THEIR NEW FINANCIAL POWER.

6. LEVER SAID, AS HE HAS BEFORE, THAT HIS VIEWS ARE
NOT FULLY ACCEPTED WITHIN THE BRITISH GOVERNMENT, THOUGH
THE PRIME MINISTER HAS BEEN RECEPTIVE AND HE EXPECTS TO
PERSUADE HIM TO PURSUE THEM WITH CHANCELLOR SCHMIDT AND
PRESIDENT GISCARD AT THE FORTHCOMING EC SUMMIT. ON THE
BASIS OF HIS CONVERSATION WITH SCHMIDT IN BONN EARLY
THIS MONTH, HE THINKS SCHMIDT WILL BE RECEPTIVE. IF
THE US, GERMANY AND FRANCE CAN BE CONVINCED, HE FEELS

SURE OTHER CONSUMER COUNTRIES WILL FALL IN LINE.

7. IN COMMENT ON VARIOUS PROBLEMS WHICH HAVE BEEN RAISED, LEVER SAID HE SEES NO SERIOUS DANGER THAT INDEXING WILL BE CARRIED OVER TO OTHER COMMODITIES; THE CASES ARE DIFFERENT. IN FACT IF THEY ARE SATISFIED THE OPEC COUNTRIES MAY BE LESS LIKELY TO BACK

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CARTELIZATION SCHEMES OF OTHER PRODUCERS. THE DEAL HE WOULD MAKE OF COURSE WOULD BE FOR A LIMITED PERIOD (THREE OR FIVE OR SEVEN YEARS, HE IS NOT PREPARED TO SAY JUST HOW LONG; THIS HAS TO BE ANALYZED) AND WOULD COVER LARGE PARTS OF CONSUMER IMPORTS FROM THE OPEC COUNTRIES (PERHAPS 80 PERCENT OF PRESENT IMPORTS ON AVERAGE, BUT PRESUMABLY VARYING AMONG CONSUMER COUNTRIES) IN RESPONSE TO THE COMMENT THAT MANY OIL PEOPLE STILL SEEM TO EXPECT A PRICE FALL AND BREAK UP OF OPEC, LEVER NOTED THAT THERE HAS BEEN LOW DEMAND IN THE PAST YEAR BECAUSE OF RECESSION, BUT THE OPEC COUNTRIES HAVE REDUCED PRODUCTION, SHOWN NO SIGNS OF BREAKING UP, AND ARE CONTEMPLATING PRICE INCREASES. DEMAND OF COURSE WILL INCREASE AS WE PULL OUT OF THE RECESSION. THE BASE PRICE FOR INDEXATION OF COURSE WOULD BE FOR NEGOTIATION.

8. COMMENT: THESE ARE VIEWS WHICH LEVER HAS BEEN PUTTING FORTH FOR A YEAR OR MORE (REFTEL AND PREVIOUS). THEIR VALIDITY OBVIOUSLY DEPENDS ON THE VALIDITY OF HIS JUDGMENT THAT OPEC WILL NOT BREAK UP IN THE NEXT FEW YEARS AND WILL HAVE A MONOPOLY POWER UNTIL ADEQUATE ALTERNATIVE ENERGY SOURCES ARE DEVELOPED. HOWEVER THE DEVELOPMENTS OF THE PAST YEAR APPEAR TO STRENGTHEN HIS CASE; IN A SITUATION OF LOW DEMAND, THEY HAVE CUT PRODUCTION AND MAINTAINED THEIR SOLIDARITY. AND DEMAND HAS BEEN LOW DUE PRIMARILY TO THE RECESSION RATHER THAN TO OUR CONSERVATION EFFORTS, AND WILL INCREASE AS THE BUSINESS CYCLE MOVES FORWARD.

9. I HAVE NOT HAD THE BENEFIT OF HEARING A FULL PRESENTATION BY THOSE WHO TAKE AN OPPOSITE VIEW (EXCEPT FOR ONE OR TWO LOCAL OIL MEN WHO ARE NOT VERY PERSUASIVE) BUT LEVER SEEMS TO ME TO HAVE MADE A STRONG PRIMA FACIE CASE. IT IS OBVIOUSLY NOT IN THE INTEREST OF THE OPEC COUNTRIES TO BREAK UP AND COMPETE FOR THE MARKET AND NOT OBVIOUS WHY WE SHOULD EXPECT THIS TO HAPPEN OR OTHERWISE EXPECT OIL PRICES NOT TO RISE UNTIL SEVERAL YEARS AHEAD WHEN ALTERNATIVE OIL AND OTHER ENERGY SOURCES ARE PRODUCING (IF INDEED DEVELOPMENT IS MOVING FAST ENOUGH TO KEEP UP WITH DEMAND EVEN THEN).DW
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10. WE CAN GIVE
A MORE FULL ACCOUNT OF LEVER'S VIEWS
IF ELABORATION ON PARTICULAR POINTS WOULD BE USEFUL.

RICHARDSON

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